



Justin Fox

Debunking the efficient markets myth

A “REVOLUTION” in finance theory over the past decade has led to a rethink of many investment ideas, such as financial markets are rational and efficient, according to Justin Fox, editorial director of the *Harvard Business Review* and author of the book *The myth of the rational market: A history of risk, reward and delusion on Wall Street*.

Fox says that in the past six months or so, yields on US Treasury bonds have not moved much.

“Does that mean that markets are really, really smart, and they can see through all the name-calling and posturing in Washington, and could tell it was going to get worked

out?” Fox says.

“Maybe. Or, was it that markets are just incapable of accounting for a really big, huge, event like that?”

“You can ask similar questions about market movements around the world over the past day. Is it that investors all around the world have made this thoughtful assessment of the risks and the rewards out there, and have decided, ‘OK, we think it’s riskier than we thought before, so we’re going to drive prices down?’”

Fox says other previously-held investment truisms also have not held up.

“One is just, ‘the price is right,’” he says.

“We don’t know if the price is right or if it is wrong. That’s not helpful, I know, but that’s the truth.

“The other is that risk can always be quantified. And I think that one of the greatest dangers from this quantification of risk that’s come along, is this feeling that, OK, we’ve got a handle on all of it, because we know the beta, or we know the value at risk, or we know whatever else.

“And the corollary to that is that risk is equivalent to historical volatility, because even with a lot of advances in this [area] in the past couple of decades, that’s basically what it is all about. People look at what’s happened in the past. Sometimes they look over a decade; sometimes - like with mortgage securities in the US - they look over 10 to 15 years. And that was not useful, it was not helpful, and

probably made things worse.

“Another one is this idea that financial markets are inherently stable. There isn’t any famous paper, landmark paper, out there in the *Journal of Finance* that makes this argument, but it just infuses most of academic finance over the past 50 years.

“And finally - this is something that was really big in the US and had differing impacts elsewhere in the world - is that corporations should use as their guiding light the movements of financial markets and that stock prices should provide direction to CEOs and CFOs and the boards of directors on what decisions to make.” ■

Life risk is our speciality



Coalition marches on industrial awards

THE COALITION continues to press the Government to overhaul the industrial awards system, which assigns default superannuation funds to workers in specific industries, by asking the Productivity Commission to investigate the evidence used to select these funds.

Mathias Cormann, Shadow Minister for Superannuation, says the Government backpedalled on an election promise by rejecting a motion he put through the Senate asking the Productivity Commission to modernise default superannuation awards.

The industrial awards, determined by Fair Work Australia, are dominated by industry funds.

Cormann recognises the viability of these funds but argues they were appointed through a selection process that was not based on clear evidence - such as investment performance - that these funds were the most appropriate.

David Bushby, Senator for Tasmania and Chair of the Coalition Economics Policy Committee, echoes this criticism. He says MTAA Super was chosen as the default fund for workers in the motor industry as its governance practices were being investigated by APRA. It later emerged that MTAA Super lost millions in 2008 by poorly managing its exposure to offshore currencies.

David Bradbury, Parliamentary Secretary to the Treasurer, acknowledges the process for selecting industrial awards is a "divisive" subject. He agrees that default funds should be chosen on the basis of clear evidence that they are the best funds for workers in particular industries.

"The Government's stance is clear: we will go through the process with the Productivity Commission," Bradbury says.

"Bring it on," replies Bushby.

Both Bushby and Bradbury say that financial literacy among Australians should be fostered.

"It's probably in the government's fiscal interests in the long-term, particularly as the

population ages, to encourage people to plan properly for their retirements," Bushby says. "It keeps the pressure off paying pensions."

He says this pressure on government coffers will increase as the baby boomers age.

Bradbury says fostering better financial literacy among Australians, which includes cutting through to disengaged members, is "one of the most challenging areas of public policy that we face".

"In the hurly-burly of daily life, what people face every day may seem more important than choosing a product to manage their savings for retirement," Bradbury says. ■

Howard: 'unreliable witness on politics'

JOHAN HOWARD is optimistic, "an unreliable witness on politics," bullish on the Australia-China relationship, a Tony Abbott fan and a global warming sceptic.

"On the whole issue of global warming I'm agnostic. I'm not sure," says Howard. "There is too much zealotry in the climate change debate."

A relaxed and comfortable Howard says that until the US, China and India charge a carbon tax there will always be suspicion about a carbon tax among Australians.

The second-longest serving Australian Prime Minister after John Menzies says in 50 years India could become a more powerful country than China. India doesn't

have to tackle the question of how to manage an ageing population, unlike China.

Howard says China's government will have to give political freedom to its citizens.

"There has to come a time when the Chinese population who have enjoyed growing economic freedom will want political freedom," he says.

Howard says Australia's relationship with China is on firm ground.

"We have a very pragmatic political relationship with China," he says. "China wants reliable supply" of raw materials. "China won't put up with a break down of that supply."

Howard says Julia Gillard's government "lacks authority".

"There is a sense the

government lacks authority and that won't alter until the next election," he says.

But the man who spent 33 years in the House of Representatives also says he is "an unreliable witness on politics".

Howard says he is close to Tony Abbott.

"I hold him in high regard," he says. "I remain in regular contact with Tony."

A fan of the United States, Howard says its economy will recover.

"Nine per cent unemployment in America is an historical aberration," he says. "There is a sense there could be a second dip" into recession. "I'm more optimistic than that." ■

John Howard



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FROLICH ABOUT

If you ask Nick Frolich, the domestic head of sales for technology vendor GBST, about the past few months, he probably won't say much about financial market volatility or the enduring superannuation reform debate.

Frolich's sales role at former employer DST Global Solutions, where he worked for 16 years, was made redundant in February. He had six months of gardening leave ahead of him. But after lining up a job with GBST in Australia, reporting to Rob de Dominicis, the company's London-based head of wealth management, Frolich gained a one-month leave pass from his wife and took to the winds. He rode waves and spent time with relatives in his native South Africa, where, as a younger man, he learned to surf when shark thriller *Jaws* was released. So on this trip he decided to face his

greatest aquatic fear in the chilly waters off Cape-town by cage-diving among the fierce predators and feeding them from the boat. There is a shaky video on his Blackberry, taken from the safety of the boat deck, of a large tuna head bobbing on the ocean surface. But not for long. A four-and-a-half metre Great White soon launches from the depths below to devour the bait in one savage go. Frolich later let the adrenaline of this experience subside in the soothing waters, hot sun and barrelling reef breaks of Fiji. Unbalanced enjoyed hearing his stories over a Boag's at the FSC late night bar. But it was then that we realised how well-timed his re-entry to the wealth management industry was. What better way to catch up with work friends, contacts, clients and prospects than spend your first day in a new job at day one of the FSC Annual Conference.

FUTURE'S SO COOL

Some of the best ideas are born of necessity, and Unbalanced has had a great idea about a sponsorship opportunity for next year's conference. It's based on sound market research and clear customer demand: sunglasses. If the state of conference delegates the morning after the night before is a reliable guide - and it usually is - we're on to a winner, for a number of reasons. First, they reduce the glare that generally follows a big night. And second, no one can see your eyes.

So one (no names, but you know who you are) may fall asleep in the corner holding your coffee, and no one can tell.

AWWW - MOM!

Sometimes the hardest people in the world to impress are your own parents. And it doesn't matter who you are. Take Bill Sharpe, the guy behind (among other things) the Sharpe Ratio. The day after the 1987 sharemarket crash, Sharpe was asked what he thought had led

to the crash. It was possible, he suggested, that all investors had come to the same rational conclusion about prices at exactly the same moment. On the other hand, though, "it's weird". The day after that quote appeared in the newspaper, Sharpe's mother called him: "Fifteen years of education, three advanced degrees, and all you can say is, 'It's weird'?" Three years later her son won the Nobel Prize in economics. What she said to him then isn't recorded.

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